No. 9837

United States
Circuit Court of Appeals

For the Ninth Circuit.

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, Trustee of the John and Pauline Tonningsen Trust,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transcript of the Record

Upon Petition to Review a Decision of the United States Board of Tax Appeals.

PARKER PRINTING COMPANY, 545 SANSOME STREET, SAN FRANCISCO

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

United States Circuit Court of Appeals
For the Ninth Circuit

No. 99280

JOHN AND PAULINE TONNINGSEN TRUST, BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, Trustee,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

AGREED STATEMENT OF THE PROCEEDINGS ON REVIEW

Come now the parties to the above entitled cause, and by their counsel of record agree that, pursuant to the rules of this court in such case made and provided (Rule 76 of the Federal Rules of Civil Procedure as incorporated into Rule 30 of this court), the following statement shows how the questions regarding which review is sought arose and were decided before the United States Board of Tax Appeals, sets forth as many of the facts averred and proved or sought to be proved as are essential to a decision of said questions by this court, and is in all respects sufficient to enable this court to review the cause and [1*] determine the issues presented herein by the petitioner on review.

*Page numbering appearing at foot of page of original certified Transcript of Record.

thereto to avoid the penalty prescribed by section 291 of said Act.

Statement of How Questions Arose and Were Decided in the Board of Tax Appeals

One notice of deficiency covering all of the foregoing matters was mailed to petitioner by respondent on March 22, 1939. Within ninety days after the mailing [4] of said notice petitioner filed its petition with the Board of Tax Appeals for a redetermination of said deficiencies, including said penalty. Respondent filed his answer, and the case was duly set for hearing, and was heard on oral testimony and certain exhibits, at San Francisco, California, on May 22, 1940, the Honorable Clarence V. Opper presiding.

After hearing, and on December 10, 1940, said Board promulgated and entered its Findings of Fact and opinion, a copy of which is annexed hereto as "Exhibit C" and hereby made a part hereof. Thereafter, and on January 31, 1941, pursuant to said Findings of Fact and Opinion, said Board rendered and entered its Decision, a copy of which is annexed hereto as "Exhibit D" and hereby made a part hereof. In and by said Decision said Board determined that there were deficiencies in petitioner's income tax for the years 1935 and 1936, as determined by respondent, and that there was no penalty due from petitioner for the year 1936.

Statement of Facts Averred and Proved and which are Essential to a Decision of the Questions by the Circuit Court of Appeals

Petitioner, a national banking association [5] with principal offices at San Francisco, California, is and at all times herein mentioned was the duly qualified and acting trustee of the John and Pauline Tonningsen trust (hereinafter referred to as the "trust"), created under date of August 7, 1930. The trust names John Tonningsen as the first trustor and Pauline E. Tonningsen, his wife as the second trustor, and petitioner's predecessor as the trustee.

Those parts of the trust agreement and the amendments thereto which are pertinent to the issues before the Board of Tax Appeals and to the questions presented by petitioner's Petition for Review are those specifically set forth in the Findings of Fact and Opinion of the Board of Tax Appeals, a copy of which is annexed hereto and marked "Exhibit C".

John Tonningsen died November 28, 1933. Thereafter, and until her death (January 25, 1936), the net ordinary income of the trust was paid to Pauline E. Tonningsen.

As the time of the death of John Tonningsen, respondent valued the assets of the trust at $702,-222.51. The trust estate was composed of real and personal property and yielded net income as follows: [6]

1931	$70,970.00
1932	73,984.18
1933	47,693.67
1934	45,571.58
1935 (11 months)	45,938.85

The petitioner's account for the year 1935 reveals that, from ordinary income of the trust, taxable and exempt, realized during that year, $46,858.47 was paid to Pauline E. Tonningsen and $2,417.99 was on hand at the end of the year, payable to her.

From the time of the death of John Tonningsen until her death, Pauline E. Tonningsen resided at the Hotel St. Francis, San Francisco, California, with her niece, Louise Weyer. They occupied a suite of four rooms, for which Mrs. Tonningsen paid the rent.

Prior to her husband's death, Mrs. Tonningsen had been paralyzed, and from the date of his death until her own death, at the age of eighty-three years, seven months and three days, she was confined to her bed and wheel chair. She was unable to walk and never left her suite. She was under constant care of physicians and had a day nurse and a night nurse continually in attendance. She had no servants other than the hotel afforded, and did not entertain, except to receive her close friends. [7]

The hotel books showed expenses incurred by her of $1,338.98 for November and December, 1933; $8,210.22 for 1934; $8,744.05 for 1935; and $723.91 for January, 1936. The above sums were for rent and meals for herself and Louise Weyer. Her bills for physicians' services totaled $635.00, $796.00 and $122.00 for the years 1934, 1935 and 1936, respectively.

Pauline E. Tonningsen had no children. She had

other relatives by blood and marriage, but did not remember them in her will.

At the time of her death, January 25, 1936, Pauline E. Tonningsen had an individual separate estate subsequently appraised at $87,046.67, and bank accounts in joint tenancy with Louise Weyer, in the sum of $103,067.06. Louise Weyer was the recipient of the decedent's estate, bank accounts in joint tenancy and gifts in contemplation of death, in the total sum of $161,745.92.

All payments made to Pauline E. Tonningsen were deposited in her commercial account at the Bank of America. The balance in this account was $36,615.78 on January 2, 1935, and $36,088.00 on December 31, 1935. [8] Over objection that the evidence was immaterial and irrelevant, petitioner was permitted to show that Pauline E. Tonningsen opened a savings account with the same institution on January 5, 1934, with a deposit of $228.15; that by virtue of deposits aggregating $19,047.26 and interest credits of $334.32, the balance in said account on December 31, 1934, was $19,609.73; that during the year 1935, there was deposited in this account the sum of $5,390.27 in amounts and on dates which corresponded with withdrawals from the aforementioned commercial account; that no withdrawals were made from this savings account during the life of Pauline E. Tonningsen, and that the balance therein, on December 31, 1935, including interest credits of $523.97 in 1935, which was unchanged at

the time of the death of Pauline E. Tonningsen, was $25,523.97.

After the death of John Tonningsen, Pauline E. Tonningsen made demand upon petitioner, through her attorney, for the payment of $5,000.00 a month. Pauline E. Tonningsen was informed that petitioner would not invade the corpus, but that the requested payments would be made if the consent of the charitable remaindermen were secured. During the year 1934, petitioner paid [9] Pauline E. Tonningsen $16,614.53 from the corpus of the trust, with the consent of the charities. Over objection that the evidence was immaterial, incompetent and hearsay, petitioner was permitted to show that on December 26, 1934, the attorney for Pauline E. Tonningsen addressed to each of the charitable remaindermen a letter in form and substance the same as "Exhibit E" annexed hereto and made a part hereof. Subsequently, on April 3, 1935, the charitable remaindermen executed the agreement annexed hereto and marked "Exhibit F".

During the calendar year 1935, in addition to ordinary income, which was paid out and distributed by petitioner, the trust realized the sum of $32,-785.40 as recognizable capital gains. By reason of the foregoing agreement, $9,545.80 was paid to Pauline E. Tonningsen out of the principal of the trust during that year. The capital gains realized, and the disbursements made by petitioner from principal during the calendar year 1935 are set

forth in "Exhibit G" annexed hereto and hereby made a part hereof.

Petitioner filed a return for 1935, on a cash basis, with the Collector of Internal Revenue at San Francisco, California. [10]

* * * * * *

Petitioner filed with the Collector of Internal Revenue at San Francisco a return for the year 1936, on a cash basis, on Form 1041. The amounts received and disbursed by petitioner during the year 1936, as revealed by (1) petitioner's accounts, (2) the return filed by petitioner, and (3) by respondent's determination, are set forth in "Exhibit H" annexed hereto and hereby made a part hereof.

During 1936 the petitioner realized gross taxable income of $74,989.57. Respondent concedes deductions of $3,146.74, miscellaneous expenses, and $43,450.17, capital gains permanently set aside for charitable organizations.

Petitioner's account shows: That the balance on hand in the income account at the beginning of the calendar year 1936 was $2,417.99; that prior to the death of Pauline E. Tonningsen on January 25, 1936, petitioner received income in the amount of $7,953.01; that from the foregoing there was paid $5,000.00 to Pauline E. Tonningsen and $448.78 on account of the fees of the petitioner, leaving a balance on hand at the time of her death of $4,922.22. Petitioner transferred this balance to the principal account on the [11] date of the death of Pauline E. Tonningsen.

Petitioner paid $600.00 monthly, commencing with February 26, 1936, on or about the 25th day of each month thereafter, to the individual beneficiaries mentioned in Article VII(c) of the trust agreement. These sums were charged by petitioner to the income account, as provided therein.

On May 16, 1936, petitioner paid the sum of $200.00 for the care and upkeep of the cemetery vault mentioned in Article VII(a) of the trust agreement. This sum was charged to the income account. On July 26, 1936, the Superior Court of the State of California, in and for the City and County of San Francisco, decreed that the clause of the trust providing for the care and upkeep of the cemetery vault was invalid, and authorized the trustee to hold the trust free of any obligation to keep and repair the vault.

The executors of the estate of John Tonningsen filed a Federal Estate Tax return which did not include the tax payable by virtue of the assets in the trust. Petitioner reported these assets and subsequently, on November 19, 1935, a deficiency in estate tax in the amount of $90,878.00 was proposed against the executors [12] of the estate of John Tonningsen. The executors thereupon sought to have the petitioner pay all or a part of the deficiency out of the trust property. The executors contended that the trust was liable for all or a part of the Federal Estate Tax due from the estate, which was predicated on the inclusion of the corpus of the trust in the gross estate because of the provision for the

payment of estate tax appearing in Article VII(a) of the trust agreement. The trustees denied liability on the ground that the payments specified in Article VII(a) were to be made upon the death of the survivor of the trustors. Pauline E. Tonningsen still being alive, no payments could be made. A similar question arose in connection with the California Inheritance Tax. The trustees realized they might be liable, so they employed counsel and sought to be recognized by the Commissioner as a taxpayer. Over the objection of petitioner, respondent was permitted to introduce in evidence a letter from petioioner's attorney, in which he stated, in appealing to the Commissioner to permit the petitioner to be represented at the proceedings, that petitioner was willing to pay a share of the tax. Petitioner caused evidence to be presented to the Commissioner, and under date of March 2, 1936, the deficiency was reduced to [13] $26,037.88. The reduction in the deficiency was predicated upon the allowance by the Commissioner of $472,672.74 as the value of the remainder interest in the corpus of the trust which was allowed as a charitable gift. On April 13, 1936, by reason of minor adjustments, the deficiency was reduced to $25,645.74, and prior to June 9, 1936, after allowance for State Inheritance Tax credit, the deficiency was finally assessed in the sum of $23,424.36.

On June 12, 1936, the executors of the estate of John Tonningsen and petitioner compromised their

dispute as to the payment of the Federal Estate Tax and State Inheritance taxes. A copy of his agreement is annexed hereto and marked "Exhibit I", and hereby made a part hereof. On the part of the petitioner, said agreement was made conditional upon the consent of the charitable remaindermen. Consents and waivers in the form set forth in "Exhibit J", annexed hereto and hereby made a part hereof, were secured from the charities.

On June 30, 1936, the petitioner paid the executors of the estate of John Tonningsen, pursuant to the foregoing agreement, on account of Federal [14] Estate taxes, $15,616.24, being two-thirds of the deficiency, and $1,436.70, being two-thirds of the interest thereon, and $1,480.92, being two-thirds of the California Inheritance Tax. These sums were charged to the principal account of the trust by petitioner. The balance on hand in the income account of the trust on June 30, 1936, after the allowance of such of the payments heretofore mentioned as preceded that date, and the ordinary expenses of the trust, was $11,235.83. The executors paid the deficiency and the interest in June, 1936.

On November 16, 1935, petitioner had paid the attorney representing it in connection with the Federal Estate Tax proposed deficiency, $500.00, and had charged the same to the principal account of the trust. On July 9, 1936, $500.00 was credited to the principal account and charged against the income account of the trust, and an additional

$1,000.00 was paid to the attorney. Subsequently, on July 22, 1936, an additional $6,000.00 was paid to the attorney and charged to the income account. The sum of $7,500.00 was claimed as a deduction from gross income on the return filed for the year 1936. [15]

At the end of July, and the end of December, 1936, respectively, petitioner paid the balance of the net income on hand to the charities designated in the trust instrument. These payments aggregated $17,178.44, and were charged against the income account of the trust.

During the period from February 8, 1936, to April 2, 1936, petitioner made payments totaling $100,000.00 under Article VII(b) of the trust agreement to the parties named therein. These payments were charged to the principal account of the trust as augmented by the balance of income on hand transferred to principal on the death of Pauline E. Tonningsen.

In determining the deficiency for 1936, respondent reduced the amounts distributed by petitioner by the sum of $18,533.86, which had been charged to principal on June 30, 1936, and disallowed the deduction of the $7,500.00 paid for attorney's fees. Taxable and tax exempt income were apportioned to the payment of these amounts, and the aggregate of the taxable income thereby applied, in the sum

of $18,958.23, was made the basis of the proposed deficiency for the year [16] 1936.

Dated, May ....., 1941.

J. W. RADIL
F. J. KILMARTIN
Attorneys for Petitioner
J. P. WENCHEL
Chief Counsel, Bureau of Internal Revenue
ALVA C. BAIRD
T. M. MATHER
HARRY R. HORROW
Attorneys for Respondent [17]

The undersigned Member of the United States Board of Tax Appeals hereby approves the foregoing Agreed Statement of the Proceedings on Review, pursuant to Rule 76 of the Federal Rules of Civil Procedure.

Dated, May 28, 1941.

(Sgd) CLARENCE V. OPPER
Member, United States Board of Tax Appeals

[Endorsed]: U. S. B. T. A. Filed May 26, 1941. [18]

EXHIBIT A

United States Board of Tax Appeals

Docket No. 99280

JOHN AND PAULINE TONNINGSEN TRUST, BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, Trustee,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR REVIEW

Bank of America National Trust and Savings Association, Trustee of the John and Pauline Tonningsen Trust, hereby petitions for a review in the United States Circuit Court of Appeals for the Ninth Circuit from so much of the decision of the Board of Tax Appeals which was entered in the above entitled matter on January 31, 1941, pursuant to findings of fact and opinion promulgated December 10, 1940 (43 B. T. A. 37 [No. 8]), as determined that petitioner was liable for deficiencies in income taxes for the calendar years 1935 and 1936.

Nature of the Controversy

This controversy involves asserted deficiencies in the petitioner's income taxes for the taxable years 1935 and [19] 1936 in the amounts of $4,610.65 and

$1,713.74, respectively, and an alleged penalty of $428.44 for the calendar year 1936.

The question in reference to the year 1935 is whether petitioner is entitled to a deduction under the provisions of section 162(a) of the Revenue Act of 1934, of capital gains realized by it during that year as gross income, which, pursuant to the terms of the deed creating the trust, was, during the taxable year, permanently set aside for or to be used for charitable purposes in accordance with the provisions of said Act.

The questions in reference to the year 1936 are, first, whether, by reason of the provisions of the trust, there should be included in petitioner's taxable income sums paid by it to the legal representative of the estate of the first trustor in satisfaction of a controversy regarding the liability of the trust for Federal Estate taxes and State Inheritance taxes arising on the death of said trustor, which said sums petitioner purported to pay out of the principal of the trust, and whether there should be an attendant denial of a deduction under section 162(a) of the Revenue Act of 1936, of amounts which petitioner purported to pay out of income to charitable beneficiaries of the trust; and, second, whether, by reason of the provisions of the trust, there should be included in petitioner's taxable income sums paid [20] by it for legal expenses attendant to securing a reduction in Federal Estate Taxes, which said sums petitioner purported to pay out of the income of the trust, and, if so, whether said

sums are an allowable deduction under sections 162 and 23(a)(1) of the Revenue Act of 1936.

The question with reference to the penalty was determined in favor of petitioner and against respondent, and no review is sought of said determination.

The Court in Which Review Is Sought

Petitioner seeks review in the United States Circuit Court of Appeals for the Ninth Circuit.

Allegations to Establish Venue

Petitioner is and was during the taxable years in controversy a national banking association duly incorporated under the laws so provided, with its principal offices at San Francisco, California. The Collector's Office to which was made the returns of taxes, in respect of which the liability is alleged to arise, is located at San Francisco, California, in the Ninth Judicial Circuit.

Wherefore, petitioner prays that the proceedings of the Board of Tax Appeals in the above entitled matter, [21] in so far as it was therein determined that petitioner was liable for deficiencies in income taxes for the years 1935 and 1936, be reviewed by the United States Circuit Court of Appeals for the Ninth Circuit; that the Clerk of the Board of Tax Appeals prepare and transmit to said United States Circuit Court of Appeals for the Ninth Circuit a record of the proceedings before said Board of Tax Appeals in the manner and form provided by the

statutes of the United States, the Rules of said Board of Tax Appeals, the Rules of said Circuit Court, and the Federal Rules of Civil Procedure; and petitioner further prays that upon said review the aforementioned findings of fact and conclusions of law and decision of the Board of Tax Appeals, in so far as they determine said deficiencies, be reversed and said petitioner relieved of the deficiencies imposed thereby.

J. W. RADIL,
F. J. KILMARTIN,
Attorneys for Petitioner.

[Endorsed]: U. S. B. T. A. Filed April 26, 1941. [22]

EXHIBIT B

[Title of Board and Cause.]

STATEMENT OF POINTS TO BE RELIED UPON ON APPEAL

For the Alleged Deficiency for 1935

I.

The Board of Tax Appeals erred in its decision that there is a deficiency in petitioner's income tax for the year 1935.

II.

The Board of Tax Appeals erred, in that the following findings of fact, express or implied, are not supported by the evidence:

A.

That the capital gains which were added to corpus in 1935 cannot be said to have been paid or permanently set aside for charitable purposes pursuant to the terms of the instrument creating the trust. [23]

B.

(1) That there was a reasonable likelihood that the capital gains for 1935 were not protected from invasion in favor of the individual beneficiaries pursuant to the terms of the instrument creating the trust; and

(2) That the corpus, of which these capital gains became an indistinguishable part, was not so protected from invasion, pursuant to the terms of the instrument creating the trust and the circumstances of the beneficiary and trust estate, as to demonstrate that said capital gains were, pursuant to the terms of the instrument creating the trust, permanently set aside for the benefit of charities.

C.

(1) That Pauline Tonningsen was in 1935, or would be during her lifetime, in need of a greater amount than the ordinary net income of the trust for her care, maintenance and support, or by reason of illness or other emergency;

(1b) That Pauline Tonningsen had more than one nurse continuously in attendance from the date of the death of John Tonningsen until her own death; and

(2) That petitioner deemed such amounts as were actually paid to Pauline Tonningsen from the corpus of the trust during 1934 and 1935 or, in the exercise of its absolute discretion would have occasion in the future to deem further amounts from the corpus of the trust, necessary [24] and appropriate for the care, maintenance and support of Pauline Tonningsen or by reason of her illness or other emergency.

D.

(1) That Pauline Tonningsen was within her rights in demanding payments, pursuant to the terms of the instrument creating the trust, from the corpus thereof;

(2) That the consent of the charitable remaindermen to such invasions proceeded from a recognition on their part that a litigated contest over her right, under the terms of the instrument creating the trust, would result unfavorably to them; and

(3) That the consent of the charitable remaindermen would be forthcoming for ensuing years during the life of Pauline Tonningsen.

III.

The Board of Tax Appeals erred in that it failed to find as follows in conformance with the evidence:

A.

That the capital gains realized by petitioner in 1935 were permanently set aside and used for char-

itable purposes pursuant to the terms of the instrument creating the trust.

B.

That there was no likelihood or reasonable probability [25] that the corpus of the trust estate was or would be subject to invasion, pursuant to the terms of the instrument creating the trust, for the care, maintenance or support of Pauline Tonningsen, or by reason of her illness or other emergency.

C.

That the amounts paid out of corpus to Pauline Tonningsen in 1934 and 1935 were not paid or payable to her pursuant to the terms of the instrument creating the trust but were, in fact, paid out of the equitable interest of the charitable remaindermen of the trust by agreement with them.

IV.

That the Board of Tax Appeals erred in that the following conclusions of law are contrary to law:

A.

That the capital gains which were added to corpus in 1935 cannot be said to have been paid or permanently set aside for charitable purposes pursuant to the terms of the instrument creating the trust.

B.

(1) The conclusions set forth under parts (1) and

(2) of section B of paragraph II, above, in so far as they embody conclusions of law; and

(2) That the question (of the reasonable likelihood of the invasion of corpus) is a "'factual one'", [26] controlled not by the legal rights of the parties but by the actual probabilities.

C.

The conclusions set forth under part (2) of section C of paragraph II, above, in so far as it embodies conclusions of law.

D.

The conclusions set forth under parts (1) and (2) of section D of paragraph II, above, in so far as they embody conclusions of law.

For the Alleged Deficiency for 1936

I.

The Board of Tax Appeals erred in its decision that there is a deficiency in petitioner's income tax for the year 1936.

II.

The Board of Tax Appeals erred in that the following findings of fact, express or implied, are not supported by the evidence:

A.

(1) That pursuant to the terms of the instrument creating the trust the state inheritance tax or federal estate tax due by virtue of the death of the trustor first to die, as distinguished from that

ensuing on the death of the survivor, was to be paid from the trust. [27]

(2) That pursuant to the terms of the instrument creating the trust, any state inheritance tax or federal estate tax properly chargeable against the trust was to be paid from income received after the death of the survivor.

(3) That there was any state inheritance tax or federal estate tax due from the trust, or any share or interest therein; and

(4) That the trust deed required that the estate taxes and attorneys' fees be paid out of income of the trust received in the year of the death of the survivor, if sufficient therefor.

B.

(1) That the trust was not engaged in a trade or business; and

(2) That the attorneys' fees were not deductible as an ordinary and necessary business expense.

C.

That the trustee was precluded from distributing, pursuant to the terms of the instrument creating the trust, income equal to the amounts paid out for estate taxes and attorneys' fees, to the charitable beneficiaries.

III.

The Board of Tax Appeals erred in that it failed to find as follows in conformance with the evidence: [28]

A.

(1) That pursuant to the terms of the instrument creating the trust, the only state inheritance tax or federal estate tax to be paid by the trust was that due by virtue of the death of the survivor.

(2) That pursuant to the terms of the instrument creating the tax, any state inheritance tax or federal estate tax properly chargeable against the trust was to be paid from income only in so far as income was sufficient at the date of the death of the survivor.

(3) That the sum of $18,533.86 was paid to the executors of John Tonningsen, not as a tax, but by way of compromise of an alleged liability.

(4) That under the terms of the instrument creating the trust petitioner properly paid the sum of $18,533.86 from the corpus of the trust; and

(5) That the attorneys' fees as an extraordinary expense of the trust were properly payable out of the corpus of the trust pursuant to the terms thereof.

B.

That the attorneys' fees, if properly payable out of the income of the trust, were a deductible expense.

C.

That petitioner was entitled to deductions of $11,600.00 for distribution to individual beneficiaries, and [29] $17,178.45 for distribution to the charitable beneficiaries in the year 1936.

IV.

That the Board of Tax Appeals erred in that the following conclusions of law are contrary to law:

A.

The conclusions set forth under parts (1), (2), (3) and (4) of section A of paragraph II, above, in so far as they embody conclusions of law.

B.

The conclusions set forth under parts (1) and (2) of section B of paragraph II, above, in so far as they embody conclusions of law.

C.

The conclusions set forth in section C of paragraph II, above, in so far as it embodies conclusions of law.

J. W. RADIL,
F. J. KILMARTIN,
Attorneys for Petitioner.

[Endorsed]: U. S. B. T. A. Filed April 26, 1941.

[30]

EXHIBIT C

[Title of Board and Cause.]

Docket No. 99280. Promulgated December 10, 1940.

FINDINGS OF FACT AND OPINION

1. Where corpus of trust was in fact invaded and payments therefrom made to life bene-

ficiary, capital gains allocable to corpus under California law were not "permanently set aside" for charitable remaindermen so as to justify the deduction provided by section 162 (a), Revenue Act of 1934.

2. Where trust instrument provided for the payment of estate taxes and attorneys' fees out of the income of the trust, income thus used held not paid to charities within section 162 (a), Revenue Act of 1936.

3. Where trust filed information return 1041, adequacy of information given therein not being challenged, and regulations not clearly providing for filing of additional return, held imposition of penalty under section 291 of the Revenue Act of 1936 for failure to file return "required by this title" unauthorized.

F. J. Kilmartin, Esq., and J. W. Radil, Esq., for the petitioner.

Harry R. Horrow, Esq., for the respondent.

This proceeding was brought for a redetermination of deficiencies in income tax for the years 1935 and 1936 in the amounts of $4,610.65 and $1,713.74, respectively. A penalty of $428.44 is asserted for the year 1936.

The sole question involved with respect to the year 1935 is whether petitioner is entitled to a deduction under the provisions of section 162 (a) of the Revenue Act of 1934 of capital gains realized by it during the year but covered into corpus as an

accretion thereto and not distributed as net income to the life beneficiaries.

With respect to the year 1936 the questions are whether by reason of provisions of the trust there should be included in petitioner's taxable income sums paid by it for legal expenses and Federal estate taxes or whether these items give rise to a deduction under the provisions of section 162 (a) of the Revenue Act of 1936, and whether the asserted penalty for failure to file should be sustained. [31]

FINDINGS OF FACT.

Petitioner, a national banking association with principal offices at San Francisco, California, is and at all times herein material was the duly qualified and acting trustee of the John and Pauline Tonningsen trust (hereinafter referred to as the trust), created under date of August 7, 1930. The trust names John Tonningsen as the first trustor and Pauline E. Tonningsen, his wife, as the second trustor and petitioner's predecessor, the trustee.

Those parts of the trust agreement and the amendments thereto which are pertinent to the issues before us are as follows:

> Article IV.
>
> The Trustee shall take, collect and receive the income of the trust fund and estate, and after paying therefrom the costs and expenses of the trust, shall pay said net income to the First Trustor during his lifetime * * *.

In the event that the Second Trustor should survive the Trustor, and this Trust becomes irrevocable under the provisions hereinafter contained, the Trustee shall pay to said Second Trustor, all of the net income of the trust fund and estate, in convenient installments, as nearly equal in amount as the condition of the Trust will permit, and should the said Second Trustor be in need of a greater amount than said net income for her care, maintenance and support, or by reason of illness or other emergency, the Trustee may, in its absolute discretion, pay to her, out of the principal of the trust fund and estate, such additional amounts as it may deem necessary and appropriate for the purposes aforesaid, and no one, howsoever interested in the Trust, shall be competent to object thereto.

* * * * * * *

Article VII.

If not revoked by the First Trustor, during his lifetime, the Trust shall become irrevocable upon the death of the First Trustor, and should the Second Trustor survive him, the Trust shall be administered for her use and benefit as hereinbefore provided, and upon the death of the survivor of the Trustors, the Trustee shall administer the trust thereof in the manner following, to-wit:

(a) Out of the income of the trust fund and estate, if that be sufficient, or out of the princi-

pal thereof, if necessary, the Trustee shall pay the costs and expenses of the surviving Trustor's last illness and of his or her funeral and burial, unless other provision shall have been made therefor, and the inheritance tax upon all distributive shares of or interests in the trust fund and estate, if any be due, and any Federal Estate Tax due upon the whole thereof, and the costs and expenses of the Trust, including the compensation of the Trustee and all preferred claims or charges against the trust estate, including interest thereon, and the Trustee, during the continuance of this Trust, shall, in its absolute discretion, devote such sums as it may deem necessary for the care and upkeep of the Pierre and Pauline Somps Vault in Holy Cross Cemetery, San Mateo County, California; said vault is presumably to be cared for under a contract providing for perpetual care thereof, but if, for any reason, said vault should not be properly cared for, the Trustee is urged to and authorized to make any necessary repairs thereto.

(b) Out of any undistributed income and/or principal of the trust fund and estate, the Trustee shall make the following payments: [A direction for payment of $104,000 to specific individuals.] [32]

(c) Out of the net income of the trust fund and estate not required for any of the purposes aforesaid, the Trustee shall make the following

payments: [A direction for payment of annuities aggregating $600 per month.]

(d) The Trustee shall pay over all of the net income of the trust fund and estate, not required for any of the purposes aforesaid, in perpetuity, as follows: [A direction is made for the payment of the income in equal shares to six organizations qualifying as charitable organizations under the applicable provisions of the Revenue Act.]

* * * * * * *

Article IX.

The Trustee shall be compensated for its services as follows:

* * * * * * *

(e) Reasonable compensation to the Trustee for any extraordinary services performed by it in defending the Trust or the trust estate, or the interest of any beneficiary hereunder, including the costs and expenses of the Trustee in so doing.

John Tonningsen died November 28, 1933. At that time respondent valued the assets of the trust at $702,222.51. From that time until the date of her death on January 25, 1936, Pauline Tonningsen resided at the Hotel St. Frances, San Francisco, California, with her niece, Louise Weyer. They occupied a suite of four rooms, for which Pauline Tonningsen paid the rent.

Prior to her husband's death Pauline Tonningsen had been paralyzed and from the date of his death

until her own death she was confined to her bed and wheel chair. She was under constant care of physicians and had nurses continually in attendance. She was 81 years old when her husband died. The hotel books showed expenses incurred by her of $1,338.98 for November and December 1933; $8,210.22 for 1934; $8,744.05 for 1935; and $723.91 for January 1936. The above sums were for rent and meals for herself and Louise Weyer. She had no servants other than the hotel afforded and did not entertain except to receive her close friends.

Pauline Tonningsen's bills for physicians' services totaled $635, $796 and $122 for the years 1934, 1935, and 1936, respectively.

After the death of John Tonningsen all of the income of the trust was paid to Pauline Tonningsen. Beginning February 1934, the trustee paid Pauline Tonningsen an amount of $5,000 per month without regard to the income received by the trust, the charities who were the remaindermen of the trust having given their consent. The agreement was renewed in December 1934, and again on April 3, 1935, for a period of one year from March 1, 1935, or a shorter period in the event of Pauline Tonningsen's death. The trustee had objected to making the payments unless it was held harmless by the remaindermen. By reason of this arrangement total payments out of the corpus amounting to $16,614.53 were made in 1934 and $9,545.80 were made in 1935. [33]

At the time of her death on January 25, 1936, at the age of 83 years, 7 months, and 3 days, Pauline

Tonningsen had an individual separate estate subsequently appraised at $87,046.67 and bank accounts in joint tenancy with Louise Weyer in the sum of $103,067.06.

Louise Weyer was the recipient of Pauline Tonningsen's estate, bank accounts in joint tenancy, and gifts in contemplation of death in the total sum of $161,745.92. Pauline Tonningsen had no children. She had other relatives by blood and marriage but did not remember them in her will.

Petitioner paid out for the maintenance of the cemetery vault designated in the trust indenture the amount of $200. On July 26, 1936, the Superior Court of San Francisco County decreed that the clause of the trust providing for the care and upkeep of the cemetery vault was invalid and authorized the trustee to hold the trust free of any obligation to keep up and repair the vault.

The trust estate was composed of real and personal property and yielded net income as follows:

1931	$70,970.00
1932	73,984.18
1933	47,693.67
1934	45,571.58
1935	45,938.85

Petitioner filed a return for 1935 on a cash basis. During that year, in addition to other income, is realized the sum of $32,785.40 as taxable income from capital gains.

During 1936 petitioner realized gross taxable income of $74,989.57. Respondent concedes deductions

of $3,146.74 miscellaneous expenses and $43,450.17 capital gains permanently set aside for charitable organizations.

A deficiency in estate tax was proposed against the executors of the estate of John Tonningsen and the executors sought to have the petitioner pay all or part thereof out of the trust property, contending that the trust was liable for all or part of the Federal tax due from the estate by reason of the inclusion in the gross estate of the corpus of the trust because of the provision for payment of estate tax appearing in article VII (a) of the trust agreement. The trustees denied liability on the ground that the payments specified in Article VII (a) were to be made upon the death of the survivor of the trustors, and, Pauline Tonningsen still being alive, no payments could be made. A similar issue arose under the California estate tax. The trustees realized they might be liable, so they employed counsel and sought to be recognized by the Commissioner as a tax- [34] payer and evidenced a willingness to pay their share of the tax. A reduction was obtained in the amount of the deficiency. In determining the amount of the deficiency a deduction of $472,672.74, being the value of the remainder interest in the corpus, was allowed as permanently set aside for charitable uses.

After Pauline Tonningsen's death and on June 12, 1936, the executor of the estate of John Tonningsen and the petitioner herein reached an agreement relative to the amount of Federal and California

estate taxes which the trustees would pay, which was two-thirds of the deficiency, plus interest. Consent to this agreement and a waiver of any claims against the trustees were made by the charities which were the remaindermen.

On June 30, 1936, petitioner paid the executors of the estate of John Tonningsen, pursuant to the above mentioned agreement, on account of Federal estate taxes, $15,616.24, being two-thirds of the deficiency, and $1,436.70, being two thirds of the interest thereof, together with $1,480.92, being two-thirds of the California estate tax. This, petitioner charged to principal on its records. The executors paid the deficiency and interest in June 1936.

The sum of $7,500 was paid to the attorney representing the petitioner in connection with the dispute over the estate tax liability. This was charged to income on the records of the trust and taken as a deduction from gross income on the fiduciary return for the year 1936.

In July and December of 1936, petitioner paid to charities designated in the trust instrument the total sum of $17,178.44, which amounts were charged against income on the records of the trust.

During 1936 petitioner also made payments totaling $102,000 under article vii (b) of the trust indenture to parties named therein, which payments were charged to principal on petitioner's records.

Petitioner filed a return for the year 1936 on Form 1041. Its gross income for that year was in

excess of $5,000. No return on Form 1040 was ever filed by petitioner for the year 1936.

In determining the deficiency for 1936, respondent allocated the payments of estate tax and attorneys' fees between taxable and tax-exempt income and denied the deduction for payment to charitable institutions of the proportionate amount.

Opinion.

Opper: The first question is whether capital gains of the petitioner trust concededly allocable to corpus under California law were so "paid or permanently set aside" for charitable purposes as to [35] be exempt from income tax under Revenue Act of 1934, section 162 (a).[1]

There is no contention that any amounts were actually paid, and the question arises by reason of

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[1]Sec. 162. Net Income.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23 (o)) any part of the gross income, without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in section 23 (o), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit;

* * * * *

provisions in the trust instrument granting to certain individuals such rights to income and possibly to principal as to cause the parties to disagree whether it can be said that the capital gains in question were permanently set aside for the use of the charities, so as to be beyond the reach of distribution to the individual beneficiaries and thus to comply with the requirements of section 162 (a).

A cognate question has arisen from time to time as to exemption from estate tax under Revenue Act of 1926, section 303 (a) (3), and similar provisions of other acts. See e. g. Ithaca Trust Co. v. United States, 279 U. S. 151. It is suggested that the tendency in considering such cases has been for the courts to ascertain as nearly as may be the extent to which a gift may reasonably be considered as destined for charitable purposes and to permit the exclusion of an estimated value thereof as the nearest approximation that can be made to a necessarily final result. See Boston Safe Deposit & Trust Co. v. Commissioner (C. C. A., 1st Cir.), 66 Fed. (2d) 179, 184; certiorari denied, 290 U. S. 700.

In cases dealing with income, however, where questions identical to that now before us were involved, a more rigorous approach has been adopted on occasion, and the deduction has been denied unless enjoyment by the charitable beneficiaries is shown to be almost certain and virtually inevitable. See e. g. Bank of America National Association, Trustee, 19 B. T. A. 1273; Gertrude Hemler Tracy et al., Trustees, 30 B. T. A. 1156; Guaranty Trust

Co. of New York, Executor, 31 B. T. A. 19; Old Colony Trust Co., Trustee, 33 B. T. A. 311. But see Helen G. Bonfils et al., Executors, 40 B. T. A. 1079; affd. (C. C. A., 10th Cir.), ——— Fed. (2d) ——— (Nov. 6, 1940). See also Union Trust Co. of Pittsburgh v. Commissioner (C. C. A., 3d Cir.), ——— Fed. (2d) ——— (Sept. 27, 1940).

Whether or to what extent the two rules are in fact different, however, or which of them is more properly applicable to such a case [36] as this, we find it unnecessary to decide. For even if we adopt the approach suggested by petitioner and endeavor to determine, on the basis of the probabilities as they existed in the years involved, the reasonable likelihood that these capital gains were protected from invasion in favor of the individual beneficiaries, we are forced to conclude that the weight of evidence is contrary to petitioner's contention. Likelihood that corpus would be devoted to noncharitable purposes appears from the most cogent of circumstances, the compelling logic of actual events. It is shown that in all the relevant years such large payments were made to the individual beneficiary that a substantial amount in each year was taken from the corpus. And of course if it happened in one year there is the more reason for expecting a repetition. There is no indication that the years before us were exceptional or that the needs of the individual beneficiary were greater or the trust income less than could be anticipated in any typical period. It follows that petitioner has

failed to show that the corpus, of which these capital gains became an indistinguishable part, was so protected from invasion as to enable us to say that they were permanently set aside for the benefit of the charities. The evidence indicates the contrary.

Petitioners contend that since this invasion of corpus had the consent of the remaindermen, the charitable institutions, it is no proof that the life tenant was within her legal rights in demanding the payments from corpus. This may or may not be true, since the consent of the beneficiaries in despite of their financial interest might well proceed from a recognition on their part that a litigated contest would result unfavorably to them. But, be that as it may, our question is "a factual one", Helen G. Bonfils, supra; not what were the legal rights of the parties but what were the actual probabilities. And if the consent of the remaindermen to the invasion of corpus was obtained in one year, there would be no reason to assume that it would not be forthcoming, as in fact it was, in the next. It is unnecessary to add that there were also individual remaindermen for the payment of whose specified shares corpus would have to be used. See Bank of America National Association, Trustee, supra. We conclude that the capital gains which were added to corpus in 1935 can not be said to have been paid or permanently set aside for charitable purposes.

For the year 1936 a different question arises. Payments of estate tax on the estate of the grantor of the trust and of attorneys' fees were made by petitioner, the former being charged to corpus. An amount equal to the income of the trust was paid as such to the charitable organizations, and is claimed as a deduction in the full amount under section 162 (a). It is respondent's position in dis- [37] allowing that deduction that the payments of estate tax and attorneys' fees were actually payments out of income and to the extent thereof reduced the current income available for distribution to the charities, so that in effect what was paid to them was in reality not income but corpus and hence not deductible.

The deduction which is permitted is of "any part of the gross income, without limitation, which, pursuant to the terms of the will or deed creating the trust, is during the taxable year paid" for charitable purposes. If, as respondent contends, the parts of the gross income in question were not, pursuant to the deed creating the trust, paid to the charities, the deduction would not be available. The issue, therefore, narrows to the question whether the trust instrument provided that the payments of estate taxes and attorneys' fees should be made from income or whether it directed that the income should be used for the payments to charity.

According to the deed of trust the payments to the charitable institutions were to be the net income "not required for any of the purposes afore-

said." This is provided by article vii (d). Article vii (a) requires the trustee "out of the income of the trust fund and estate, if that be sufficient, or out of the principal thereof, if necessary" to pay "the inheritance tax upon the distributive shares of or interests in the trust fund and estate, if any be due, and any Federal estate tax due upon the whole thereof and the costs and expenses of the trust."

These provisions appear to be so clear as to offer small room for construction. The income of the trust for the year 1936 was sufficient to pay the estate taxes and attorneys' fees in question. The trust deed requires that under those circumstances they be paid out of that income. It provides for the distribution to the charities of only the income not so required, thus precluding any distribution to them "pursuant to the terms of the will or deed creating the trust" of income which had already been used pursuant to those terms for other purposes. The deduction in question accordingly finds no support in section 162 (a). See Old Colony Trust Co., Trustee, supra.

It is not entirely clear whether the payment of attorneys' fees is also claimed as a deduction on the ground of ordinary and necessary business expense. Such a claim, if made, must be denied in the complete absence of any showing that the trust was engaged in a trade or business. Deputy v. Dupont, 308 U. S. 488; White Trust v. Commissioner (C. C. A., 3d Cir.), ——— Fed. (2d) ——— (Oct. 9, 1940).

The final issue involves the proposed imposition of a penalty for petitioner's failure to file a return. The question raised is whether omission to file Form 1040 covering taxable net income of the trust, [38] although concededly Form 1041, the information return, was duly filed, subjects petitioner to the penalty imposed by section 291 of the Revenue Act of 1936.[2]

The penalty is for failure to file a return "required by this title." Section 142 entitled "Fiduciary Returns" requires "every fiduciary" to "make under oath a return for * * * (4) every estate or trust the net income of which for the taxable year is $1,000 or over; (5) every estate or

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[2]Sec. 291. Failure to File Return.

In case of any failure to make and file return required by this title, within the time prescribed by law or prescribed by the Commissioner in pursuance of law, unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be added to the tax: 5 per centum if the failure is for not more than thirty days with an additional 5 per centum for each additional thirty days or fraction thereof during which such failure continues, not exceeding 25 per centum in the aggregate. The amount so added to any tax shall be collected at the same time and in the same manner and as a part of the tax unless the tax has been paid before the discovery of the neglect, in which case the amount so added shall be collected in the same manner as the tax. The amount added to the tax under this section shall be in lieu of the 25 per centum addition to the tax provided in section 3176 of the Revised Statutes, as amended.

trust the gross income of which for the taxable year is $5,000 or over." Nothing is said as to the form on which the return must be filed and there is no contention here that the respondent was not given all the necessary information on the form which the petitioner filed. Under the respondent's regulations[3] it is by no means clear that more than one return was required in the present case, nor on which form the income should be returned by the fiduciary. It is clear that a return on Form 1041 would be required if deductions were sought under sections 162 (b) or (c), but the deductions claimed by petitioner were those described in section 162 (a), a situation as to which the regulations are

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[3]Art. 142-1. Fiduciary returns.—Every fiduciary, or at least one of joint fiduciaries, must make a return of income—

* * * * *

(b) For the estate or trust for which he acts if the net income of such estate or trust is $1,000 or over, or if the gross income of the estate or trust is $5,000 or over, regardless of the amount of the net income, or if any beneficiary of such estate or trust is a nonresident alien.

The return in case (a) shall be on Form 1040 or 1040A. In case (b) a return is required on Form 1040 with respect to any taxable net income of the estate or trust computed in accordance with section 162 and a return on Form 1041 with respect to any income deducted under section 162 (b) or (c). If a portion of the income of the estate or trust is retained by the fiduciary and the remainder is distributable or distributed to beneficiaries, both Forms 1040 and 1041 will be required. * * *

silent. Nor, on the theory of either party to this proceeding, would the case fall within the condition that a portion of the income is retained by the fiduciary and the remainder distributed, since on petitioner's theory none of the taxable income was retained and, on the respondent's, all. We are accordingly unable to say that the missing return was required by the specified title of the revenue act, even though its provisions be amplified by reference to respondent's regulations. That being so, the necessary prerequisite for the application of the [39] penalty provision is absent. See American Circus Joint Venture, 39 B. T. A. 605. We do not purport to pass upon a case disclosing a failure to file a return clearly called for by the statute or even by respondent's regulations, whether or not that return is an additional return to one otherwise required. See Collateral Mortgage & Investment Co., 37 B. T. A. 630; Lone Pine Lawn Corporation, 41 B. T. A. 638. Questions of that kind must be left open for determination on a record and under circumstances more favorable to respondent's contention than those appearing here.

Decision will be entered under Rule 50. [40]

EXHIBIT D

United States Board of Tax Appeals
Washington

Docket No. 99280

JOHN AND PAULINE TONNINGSEN TRUST, BANK OF AMERICA NATIONAL TRUST & SAVINGS ASSN. TRUSTEE,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

DECISION

Pursuant to the Board's Findings of Fact and Opinion, promulgated December 19, 1940, the respondent herein having on January 4, 1941, filed a recomputation of tax, and the petitioner having on January 28, 1941, filed an acquiesence in said recomputation, now, therefore, it is

Ordered and decided: That there are deficiencies in income tax for the calendar years 1935 and 1936 in the respective amounts of $4,610.65 and $1,713.74, and no penalty for the year 1936.

Enter:

[Seal] (Signed) CLARENCE V. OPPER,
Member.

Entered Jan. 31, 1941. [41]

EXHIBIT E

"(PETITIONER'S EXHIBIT 9)"

John L. McNab
Attorney at Law
Crocker First National Bank Bldg.
San Francisco

December 26, 1934.

San Francisco Unit of the American Red Cross,
San Francisco, California.

Dear Sirs:

I recall to your attention the fact that John Tonningsen before his death established a trust of about half a million dollars with the Bank of America for six beneficiaries, of which you are one.

In reality this was not John Tonningsen's property. It was the property of his wife. She was inclined to attack the trust and had she done so would probably have been successful. She was persuaded not to engage in litigation.

The Bank agreed for one year to pay her $5,000.00 per month, regardless of the amount of the income. The income is now something like $2200.00 per month. That year has expired.

Mrs. Tonningsen is bedridden and has been trying to build up a fund to take care of certain relatives of hers whom John Tonningsen excluded under his Will to her bitter disappointment.

The Bank of America has decided that it will pay her only the net income, but has agreed to continue

to pay the $5,000.00 per month for another year if the charities, who are the beneficiaries, will consent.

Mrs. Tonningsen has just passed through a desperate illness, which we thought she could not survive. She is now only a frail little wisp of a woman and cannot, at best, long survive. She is constantly worried by the action of the Bank and frets continuously. She calls me several times a week to know if the matter has been arranged.

In short, the situation that I put to you is this:

You are the recipient of a large benefaction that came from her property.

I cannot believe it possible that Mrs. Tonningsen [42] can survive the year upon which we are about to enter.

She is entitled, under the trust, to the net income. The added income would amount to about $2700.00 a month.

I feel that the charities who are receiving all of this as a benefaction will consent to the Bank continuing, for the forthcoming year, but no longer, the arrangement followed during the past year, namely, the payment of $5,000.00 per month. This, of course, would end immediately on her death.

I put this matter plainly before you and ask you for your consent to the Bank of America continuing the arrangement which has been followed since John Tonningsen's death during the forthcoming year, or until her earlier death.

I am sure that by doing so you will not only re-

lieve her mind from constant worry, but would be merely performing the part of a real charity.

Yours very respectfully,
(Signed) J. L. McNAB. [43]

EXHIBIT F

"(PETITIONER'S EXHIBIT 5)"

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION,

Trust Department,
485 California Street,
San Francisco, California.

April 3, 1935

Subject: Your San Francisco Trust No. 1438, John Tonningsen, deceased,

Reference is hereby made to that certain Trust Agreement dated August 7, 1930, executed by and between John Tonningsen and Pauline E. Tonningsen, as Trustors, and Bank of Italy National Trust and Savings Association, (now Bank of America National Trust and Savings Association) as Trustee, and to the trusts therein declared and set up.

Whereas said John Tonningsen died on November 28, 1933, and by the terms of said Trust Agreement the net income from said trust has been since the death of said John Tonningsen and now is payable to Pauline E. Tonningsen as surviving Trustor; and

Whereas by the terms of said Trust Agreement

it is further provided that should the net income from the trust be insufficient for the proper support, care and maintenance of said Pauline E. Tonningsen that the Trustee may, in its absolute discretion, pay to her out of the principal of the trust fund and estate such additional amounts as it may deem necessary and appropriate therefor; and

Whereas said Pauline E. Tonningsen has requested the payment to her from income and/or principal of the trust estate the sum of Five Thousand Dollars ($5,000.00) monthly, stating that said payments are necessary for her proper support, care and maintenance; and

Whereas the present net income from the trust is insufficient to provide for such payments and it will be necessary in order to make such payments for the Trustee to augment the net income from the trust estate by payments from the principal thereof; and

Whereas the undersigned charitable organizations by the terms of the Trust Agreement above referred to are now vested with the right to the income of the trust in perpetuity subsequent to the death of Pauline E. Tonningsen, save and except certain annuities payable to individuals; and [44]

Whereas the undersigned charitable organizations have signified their consent to the withdrawal from the principal of the trust estate of sufficient amounts to augment the income from the trust estate so as to assure the payment to Pauline E. Tonningsen of Five Thousand Dollars ($5,000.00) monthly for the

period of one year commencing March 1, 1935, or until her death should she die prior to the expiration of said period, and have further approved, ratified and confirmed all payments from the principal of the trust estate heretofore made by the Trustee to said Pauline E. Tonningsen in addition to the payment to her of the net income of the trust;

Now, therefore, the undersigned charitable organizations hereby approve of and consent to the payment by the Trustee from the principal of the trust estate of such amounts as which together with the net income of the trust will provide for a monthly payment to said Pauline E. Tonningsen of Five Thousand Dollars ($5,000.00) for the period of one year commencing March 1, 1935, or until the death of said Pauline E. Tonningsen, should she die prior to the expiration of said period and hereby ratify, approve and confirm all payments heretofore made by the Trustee to said Pauline E. Tonningsen from the principal of the trust estate and, in consideration of said payments of principal made and to be made by said Trustee to said Pauline E. Tonningsen, hereby jointly and severally release the Trustee from any and all liability to the undersigned, or any of the, by reason of the said payments, herein re-

ferred to, so made or to be made to the said Pauline E. Tonningsen.

SHRINERS HOSPITAL FOR CRIPPLED CHILDREN,

By .....

By .....

MASONIC HOMES OF CALIFORNIA,

By .....

By .....

BOY SCOUTS OF AMERICA,

By .....

By .....

SAN FRANCISCO COMMUNITY CHEST,

By .....

By .....

SAN FRANCISCO TUBERCULOSIS ASSOCIATION,

By .....

By .....

SAN FRANCISCO CHAPTER, AMERICAN RED CROSS,

By (Signed) W. H. AVERY

By ..... [45]

EXHIBIT G

PRINCIPAL ACCOUNT—1935

			Disbursed	Received Cost	Received Gain
Jan.	2	On Hand	$	$ 2,711.17	$
Feb.	5	Sale of Bonds		31,925.00	2,525.00
	13	Reinvested	35,807.50		
Mar.	18	Attorney's Fees	100.00		
	21	Sale of Bonds		2,400.00	1,170.00
	25	State Inheritance Tax	4,216.48		
Apr.	13	Sale of Bonds		3,172.50	245.91
	18	Pauline E. Tonningsen	3,384.47		
	30	Pauline E. Tonningsen	2,189.62		
May	2	Sale of Bonds		2,115.00	129.18
	15	Amortization of Premium		2.82	
	27	Sale of Bonds		2,115.00	106.86
	31	Pauline E. Tonningsen	2,304.24		
June	15	Amortization of Premium		18.40	
July	31	Pauline E. Tonningsen	634.40		
Aug.	29	Sale of Bonds		1,057.50	65.00
	31	Pauline E. Tonningsen	1,032.07		
Oct.	7	Sale of Bonds		19,000.00	32,501.00
	10	Reinvested	50,500.63		
	30	Sale of Bonds		3,600.00	1,740.00

			Disbursed	Received Cost	Received Gain
Nov.	8	Reinvested	6,131.25		
	13	Sale of Bonds		2,400.00	1,160.00
	15	Amortization of Premiums		5.26	
	16	Attorney's Fees (1)	500.00		
	22	Reinvested	3,044.06		
	30	Pauline E. Tonningsen (2)	1,216.20		
Dec.	4	Sale of Stock		650.00	503.47
	11	Sale of Stock		650.00	615.97
	13	Adjustment (2)	[1,216.20]		
	16	Amortization of Premiums		53.32	
	20	Reinvested	2,027.50		
	26	Sale of Stock		650.00	565.97
	30	Reinvestment	1,016.88		
		Total	$112,889.10	$ 72,525.97	$ 41,328.36
		Balance Dec. 31, 1935		$ 965.23	
		Adjustment July 9, 1936 (1)	[$500.00]		
		Unrecognized gain			$ 8,542.96
		Recognizable gain			$ 32,785.40

Notes: (1) $500.00 paid to attorney was charged back to the income account in 1936.
(2) $1,216.20 paid to Pauline E. Tonningsen was charged back to income.

EXHIBIT H

1936

INCOME, DEDUCTIONS, ETC.

	Income Account	Return	Audit
Net Rentals—Less Commissions	$ 30,764.40	$ 30,764.40	$ 30,764.40
Dividends	775.00	775.00	775.00
Capital Gains		43,450.17	43,450.17
Total Taxable Income		$ 74,989.57	$ 74,989.57
Less—Gains, set aside			$ 43,450.17
Balance	$ 31,539.40		$ 31,539.40
Less Conceded Deductions (1)	3,147.74	3,146.74	3,146.74
Balance	$ 28,391.66	$ 71,842.83	$ 28,392.66
Net Exempt Income—less interest paid and amortization of Bond Premium (2)	10,591.02	[10,597.02]	10,597.02
On Hand, Jan. 1, 1936	2,417.99		
Balance of Ordinary Income	$ 41,400.67	$ 71,842.83	$ 38,989.68
Attorneys Fees	$ 7,500.00	$ 7,500.00	Disallowed
Net Income on Return		$ 64,342.83	

	Income Account	Return	Audit
Pauline E. Tonningsen	$ 5,000.00	$ 5,000.00	$ 3,641.00
Individual Beneficiaries	6,600.00	6,600.00	4,806.12
Charitable Beneficiaries	17,178.45	52,742.83	987.31
Repair of Vault	200.00		
Transferred to principal on death of Pauline E. Tonningsen	4,922.22		
Exempt Income*			10,597.02
Total Deductions, etc.	$ 41,400.67	$ 64,342.83	$ 20,031.45
Net Taxable Income		$ 0	$ 18,958.23

*The Exempt Income was pro-rated by the commissioner as follows:

	Total	Taxable	Exempt	Net
Pauline E. Tonningsen	$ 5,000.00	$ 3,641.00	$ 1,359.00	See above
Individual Beneficiaries	6,600.00	4,806.12	1,793.88	" "
Charitable Beneficiaries	1,355.82	987.31	368.51	" "
Attorneys Fees	7,500.00	5,461.60	2,038.40	$ 5,461.60
Estate of John Tonningsen	18,533.86	13,496.63	5,037.23	13,496.63
	$38,989.68	$28,392.66	$10,597.02	$18,958.23

ANALYSIS OF PRINCIPAL ACCOUNT

		Account	Return	Audit
Realized from Sales (3)		$142,301.28	$142,254.78	$142,254.78
Amortization of Bond Premiums		272.20		
Execution of Lease		1.00		
From Income on Death of P. E. T.		4,922.22		
From Income for Attorney's Fees	$ 1,500.			
Less charge for same	1,000.	500.00		
On Hand, Jan. 1, 1936		965.23		
Total Principal Receipts		$148,961.93	$142,254.78	$142,254.78
Cost of Securities Sold		$	$ 69,837.73	$ 69,837.73
Unrecognized Gain			28,966.88	28,966.88
Reinvested		29,132.28		
Individual beneficiaries	$10,200.			
Less charge back	2,000.	100,000.00		
Trustees fees and expense		1,010.50		

	Account	Return	Audit
Estate of John Tonningsen			
Federal Estate Tax—principal	15,616.24		
Federal Estate Tax—interest	1,436.70		
Calif. Inherit. Tax—principal	1,480.92		
		The commissioner contends that $18,533.86 should have been charged to income.	
Calif. Inherit. Tax—interest	113.90		
Federal Estate Tax—interest	43.00		
On Hand, Dec. 31, 1936	128.39		
Total	$148,961.93	$ 98,804.61	$ 98,804.61
Taxable Gain		$ 43,450.17	$ 43,450.17

Notes: (1) $1.00 of miscellaneous expense was apparently inadvertently omitted from the return.

(2) $6.00 was apparently erroneously added to the exempt income shown on the return.

(3) $28.50 accrued interest was erroneously included in the amount received shown as the return and $75.00 was erroneously omitted therefrom, leaving a net difference of $46.50.

EXHIBIT I

(PETITIONER'S EXHIBIT 6)

This Agreement, made and entered into the 12th day of June, 1936, by the Bank of America National Trust & Savings Association, Trustee of the "John and Pauline E. Tonningsen Trust" (Trust No. 1438), hereinafter called the "Trustee", and Hugh W. Campbell, surviving Executor of the last will and testament of John Tonningsen, deceased, hereinafter called the "Executor",

Witnesseth:

Whereas, by letter, dated April 13th, 1936, the Bureau of Internal Revenue has tentatively determined the Federal estate tax liability of the above named estate, determining a deficiency in the amount of $25,645.74; and whereas, said Executor has acquiesced in said determination, and has waived the restrictions on the assessment and collection of said deficiency and consented to the assessment and collection thereof; and

Whereas, prolonged controversy has existed between the parties hereto with respect to liability for the payment of the Federal estate tax due in the Estate of John Tonningsen, deceased; and

Whereas, said parties desire a speedy and final determination of the Federal estate tax in the Estate of John Tonningsen, deceased, and with respect to the trust above referred, in accordance with the tentative determination above mentioned, and desire

further to amicably adjust the controversy above referred in order to avoid the expense and uncertainty of delay and litigation;

Now, therefore, in consideration of the premises and of the mutual promises of the parties hereinafter [49] contained, it is hereby agreed as follows:

(1) Conditional upon final determination and assessment of the Federal estate tax in the Estate of John Tonningsen, deceased, in conformity with said letter of April 13th, 1936, viz., in the amount of $25,645.74, or thereabouts, the Executor shall pay one-third (⅓) of said deficiency and of any interest required to be paid thereon, and the Trustee shall pay, at the time required for payment thereof, to the Executor two-thirds (⅔) of said deficiency and of any interest required to be paid thereon, said amount so received to be applied by said Executor to the payment of said tax.

(2) The term "Federal estate tax" as used in this agreement includes the amount thereof payable to the State of California as an estate tax, with which the Federal estate tax is entitled to credit.

(3) It is expressly agreed and understood that this agreement is intended by way of compromise between the Trustee and the Executor of the controversy above referred to, is expressly limited thereto and shall not constitute, or be deemed, or be used in any proceedings as, an admission on the part of the Trustee of liability, nor preclude the Trustee from hereafter denying any liability, for payment, reimbursement, or contribution of any tax

whatever under any circumstances, except liability for payment by way of compromise pursuant to and subject to the terms and conditions of this agreement.

(4) On the part of the Executor this agreement is conditional upon and subject to the confirmation and [50] approval thereof by the Probate Court in the estate of John Tonningsen, deceased, to be applied for by the Executor promptly upon the execution of this agreement, certified copy of the order of approval and confirmation to be furnished the Trustee in evidence thereof. On the part of the Trustee this agreement is conditional upon and subject to assent thereof by the charitable beneficiaries of the trust, in writing, in terms satisfactory to the Trustee, in evidence of which said Trustee shall furnish the Executor with a letter advising of its receipt of such satisfactory instrument.

(5) The Executor agrees to take no action to reopen the above tax determination, except with the consent of the Trustee, but if there prove to be a right to refund of the tax or any part thereof paid pursuant to the terms of this agreement, the Executor will, upon demand of the Trustee, and only with its consent, apply therefor and pay to the Trustee two-thirds (⅔) of any refund so recovered.

(6) The Executor agrees to cooperate with the Trustee and use its best effort to procure from the Bureau of Internal Revenue the certificate offered by it in its letter of June 5th, 1936, releasing said Trustee from liability for any further estate tax in so far as the Trust is concerned.

It witness whereof, the parties hereto have set their hands the day and year first hereinabove written.

BANK OF AMERICA NATIONAL TRUST & SAVINGS ASSOCIATION, Trustee,

O.K. E.K.L. By R. O. KWAPIL

O.K. L.J.R. Assistant Trust Officer

HUGH W. CAMPBELL

Surviving Executor of the last will and testament of John Tonningsen, deceased [51]

EXHIBIT J

(PETITIONER'S EXHIBIT 6)

San Francisco, California,
June 12, 1936

Whereas, the Bank of America National Trust & Savings Association, Trustee of the "John and Pauline E. Tonningsen Trust" (Trust No. 1438), is about to enter into a written agreement with Hugh W. Campbell, surviving Executor of the last will and testament of John Tonningsen, deceased, as of the date hereof, copy of which agreement is attached hereto, hereby referred to, and made a part hereof, the undersigned, a charitable beneficiary named in the John and Pauline E. Tonningsen Trust above referred to, does hereby assent to and concur in the execution and performance thereof by said Trustee

and waives any and all objection on its part thereto. And the undersigned does hereby release and forever discharge the said Trustee of all and from all claims, demands actions and causes of action whatsoever in law or in equity that it may have or hereafter can, shall, or may have for, upon, or by reason of the execution and performance thereof by the said trustee, and does hereby agree to hold said Trustee harmless against any claim by it because of the execution or performance of said agreement.

In witness whereof, the undersigned has caused this instrument to be duly executed by its officer or representative thereunto duly authorized, as of the day and year first above written.

THE IMPERIAL COUNSEL OF THE ANCIENT ARABIC ORDER OF THE
[Seal] NOBLES OF THE MYSTIC SHRINE FOR NORTH AMERICA, a corporation
By LEONARD P. STEUART
Its President
and by JAMES H. PRICE
Its Secretary.

Leo J. Rabinowitz
Attorney at Law
Mills Building
San Francisco [52]

[Title of Board and Cause.]

CERTIFICATE

I, B. D. Gamble, Clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages 1 to 52, inclusive, contain the record on appeal as agreed to by the parties in accordance with Rule 76 of the Rules of Civil Procedure for the District Courts of the United States.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 29th day May, 1941.

[Seal] B. D. GAMBLE
Clerk, United States Board of Tax Appeals.

[Endorsed]: No. 9837. United States Circuit Court of Appeals for the Ninth Circuit. Bank of America National Trust and Savings Association, Trustee of the John and Pauline Tonningsen Trust, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Upon Petition to Review a Decision of the United States Board of Tax Appeals.

Filed June 3, 1941.

PAUL P. O'BRIEN,
Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

In the United States Circuit Court of Appeals
for the Ninth Circuit

No. 9837

JOHN AND PAULINE TONNINGSEN TRUST, BANK OF AMERICA NATIONAL TRUST & SAVINGS ASSOCIATION, Trustee,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

STATEMENT OF POINTS RELIED UPON ON APPEAL AND DESIGNATION OF RECORD

Petitioner hereby adopts as its points upon appeal, pursuant to paragraph 6 of rule 19 of the above entitled court, the points set forth in its "Statement of Points to be Relied Upon on Appeal" contained in the "Agreed Statement of the Proceedings on Review" heretofore filed herein, and more particularly designated therein as "Exhibit B".

And petitioner hereby designates the entire transcript as necessary for the consideration of said appeal.

Dated, June 5, 1941.

J. W. RADIL
F. J. KILMARTIN
Attorneys for Petitioner.

[Endorsed]: Filed June 5, 1941. Paul P. O'Brien, Clerk.